

**REPORT ON EXAMINATION**  
**OF**  
**HOUSEHOLD LIFE INSURANCE**  
**COMPANY OF DELAWARE**  
**AS OF**  
**DECEMBER 31, 2005**

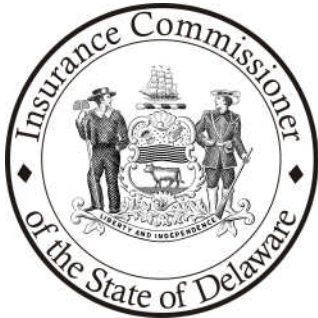
I, Matthew Denn, Insurance Commissioner of the State of Delaware, do hereby certify that the attached REPORT ON EXAMINATION, made as of DECEMBER 31, 2005 of the

**HOUSEHOLD LIFE INSURANCE COMPANY OF DELAWARE**

is a true and correct copy of the document filed with this Department.

ATTEST BY: Antoinette Handy

DATE: 17 MAY 2007



In Witness Whereof, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THIS DEPARTMENT AT THE CITY OF DOVER, THIS 17TH DAY OF MAY, 2007.

Matthew Denn  
Insurance Commissioner

**REPORT ON EXAMINATION**  
OF THE  
**HOUSEHOLD LIFE INSURANCE COMPANY OF DELAWARE**  
AS OF  
**December 31, 2005**

The above captioned Report was completed by examiners of the Delaware Insurance Department.

Consideration has duly been given to the comments, conclusions, and recommendations of the examiners regarding the status of the Company as reflected in the Report.

This Report is hereby accepted, adopted, and filed as an official record of this Department.

A handwritten signature in black ink, appearing to read "Matthew Denn", written over a horizontal line.

MATTHEW DENN  
INSURANCE COMMISSIONER

DATED this 18TH Day of MAY 2007.

## **TABLE OF CONTENTS**

	<u>Page</u>
Salutation	1
Scope of Examination	2
Description of the Company	
History	3
Capitalization	3
Dividends to Stockholders	4
Insurance Holding Company System	5
Management and Control	6
Corporate Records	8
Management and Service Agreements	9
Territory and Plan of Operation	11
Growth of the Company	11
Accounts and Records	12
Financial Statements	13
Analysis of Assets	13
Liabilities, Surplus and Other Funds	14
Summary of Operations	15
Capital and Surplus Account	16
Examination Financial Changes	16
Notes to Financial Statements	16
Compliance with Prior Report on Examination	18
Recommendations	18
Conclusion	19

## **SALUTATION**

October 5, 2006

Honorable Matthew Denn  
Commissioner of Insurance  
Delaware Department of Insurance  
841 Silver Lake Boulevard  
Dover, Delaware 19904

Dear Commissioner:

In compliance with instructions and pursuant to statutory provisions contained in Certificate of Authority Number 06-019, an examination has been made of the affairs, financial condition and management of the

### **HOUSEHOLD LIFE INSURANCE COMPANY OF DELAWARE**

hereinafter referred to as "Company" or "HLICD", incorporated under the laws of the State of Delaware. The examination was conducted at the principal offices of the Company, located at 200 Somerset Corporate Blvd., Suite 100, Bridgewater, NJ 08807.

The report of such examination is submitted herewith

## **SCOPE OF EXAMINATION**

The last financial examination was conducted by the Delaware Insurance Department as of December 31, 2002. This examination covered the three year period January 1, 2003 through December 31, 2005, and consisted of a general survey of the Company's business policies and practices; management, any corporate matters incident thereto; a verification and evaluation of assets and a determination of liabilities. Transactions and events occurring subsequent to the latter date were reviewed and have been commented upon to the extent deemed necessary.

The format of this report is designed to explain the procedures employed on the examination and the text will explain changes wherever made. If necessary, comments and recommendations have been made in those areas in need of correction or improvement. In such cases, these matters were thoroughly discussed with responsible personnel and/or officials during the course of the examination.

The examination followed rules established by the National Association of Insurance Commissioners (NAIC) Committee on Financial Condition Examiners Handbook, as adopted by the Delaware Insurance Department under Delaware insurance Code Section 526, and generally accepted statutory insurance examination standards.

In addition to noted items in this report, the following topics were reviewed and are included in the workpapers of this examination. No exceptions or errors were noted during our review of these items:

Fidelity Bond and Other Corporate Insurance  
NAIC Financial Ratios  
Employee and Agents Welfare  
All Asset and Liability items not mentioned in this report

Work papers prepared by the Company's external accounting firm, KPMG, LLP, New York, New York, in connection with the annual audit, were reviewed and relied upon to the extent possible.

### **HISTORY**

The Company was incorporated on October 24, 2000, under the laws of the State of Delaware. A Certificate of Authority, issued by the Insurance Commissioner on November 20, 2000, authorizes the Company to transact the business of life insurance, primarily credit related.

### **CAPITALIZATION**

The Certificate of Incorporation initially authorized the issuance of 100,000 shares of common stock having a par value of \$10 per share. The Certificate of Incorporation was amended with an effective date of August 22, 2005 to indemnify all Directors and Officers of liability for actions in their official capacity representing the Company. On October 24, 2000, HLICD issued 100,000 shares of common capital stock to HIG Holding Company (HIG). The aggregate value of these shares being \$1,000,000 represents all of the Company's issued, authorized and outstanding shares of common stock. In addition, HIG contributed \$20,000,000 of surplus paid-in. On November 3, 2000, the company received the aggregate of these two amounts, \$21,000,000, via a wire transfer from HIG. On January 1, 2001, HIG transferred all of the stock of Household Life Insurance Company of Arizona (HLIC-AZ) and Household Life Insurance Company (HLIC), a Michigan domiciled company to HLICD. The majority of the Company's earnings are derived from cash dividends of its downstream affiliates.

Household Life Insurance Company of Delaware

The following shows financial information on the two companies at the time of the transfer, January 1, 2001.

	<u>HLIC-AZ</u>	<u>HLIC</u>
Total Admitted Assets	\$1,080,657,549	\$1,510,459,512
Total Liabilities	1,031,757,009	1,251,746,978
Capital & Surplus	48,900,540	258,712,534

The following changes have occurred in the capital and surplus accounts since the prior examination:

	<u>Common Capital Stock</u>	<u>Gross Paid-in and Contributed Surplus Funds</u>	<u>Unassigned Surplus</u>	<u>Total</u>
12/31/02	\$ 1,000,000	\$ 327,613,074	\$ 182,583,340	\$ 511,196,414
2003 Operations			125,046,872	125,046,872
2003 Dividends			(35,000,000)	(35,000,000)
2004 Operations			127,217,282	127,217,282
2004 Dividends			(50,000,000)	(50,000,000)
2005 Operations			130,333,544	130,333,544
12/31/05	<u>\$ 1,000,000</u>	<u>\$ 327,613,074</u>	<u>\$ 480,181,038</u>	<u>\$ 808,794,112</u>

Operations is defined as: Net income, net realized and unrealized capital gains or losses, change in net deferred income tax, change in non-admitted assets and related items, change in asset valuation reserve and cumulative effect of changes in accounting principles.

**DIVIDENDS TO STOCKHOLDERS**

According to Company records for the years indicated, and as reflected in minutes of the Board of Directors' meetings, \$85,000,000 in ordinary dividends was declared and paid to the parent, HIG during the examination period. The \$35,000,000 in dividends was declared on



November 25, 2003 and paid on December 26, 2003 and the \$50,000,000 in dividends was declared on November 26, 2004 and paid on December 23, 2004.

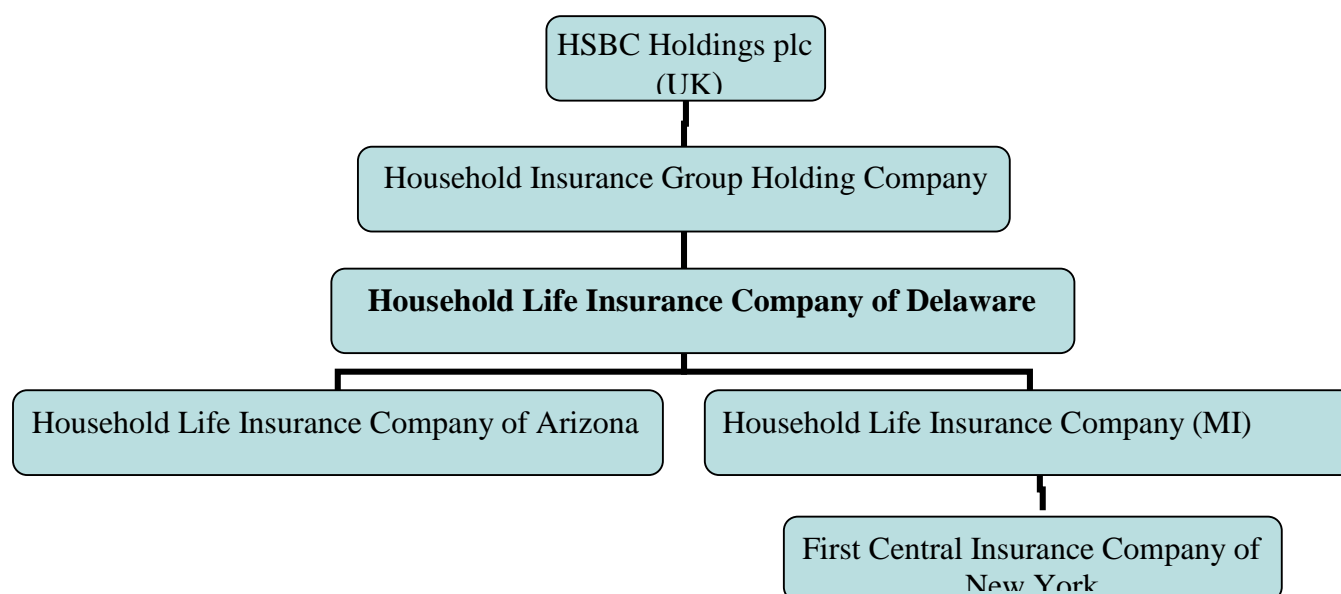
### **INSURANCE HOLDING COMPANY SYSTEM**

The Company is a member of an insurance holding company system as defined under Chapter 50, “Insurance Holding Companies” of the Delaware Insurance Code. The Company is an intermediate insurance holding company which wholly-owns the life insurance subsidiaries: HLIC, HLIC-AZ and First Central Insurance Company of New York owned by HIG whose ultimate parent was Household International, Inc (HI) which on March 28, 2003 itself was acquired by HSBC Holdings, plc (HSBC). On December 28, 2004 the Delaware Insurance Department approved the following changes in the organizational chart. Neither the ultimate parent nor the immediate parent changed, however, the former ultimate parent; HI was merged with Household Finance Corp (HFC) and renamed HSBC Finance Corp. A new indirect parent HSBC Consumer Lending (USA) Inc was formed and Household Group, Inc, an indirect parent converted to a LLC and was renamed HFC Company LLC. In May 26, 2005 a new holding company called HSBC Overseas Holdings (UK) Ltd., was added directly under HSBC the ultimate parent. HSBC headquartered in London, is one the largest banking and financial services organizations in the world. Its international network comprises more than 284,000 employees in 9,500 offices in 76 countries and territories in Europe, the Asia Pacific region, the Americas, the Middle East and Africa. HSBC provides a comprehensive range of financial services, consumer finance, commercial banking, corporate investment banking, and private banking to over 125 million customers. HSBC is listed on the London, Hong Kong, New York, Paris and Bermuda stock exchanges, shares are held by about

Household Life Insurance Company of Delaware

200,000 shareholders in over 100 countries and territories. The shares are traded on the New York Stock Exchange in the form of American Depositary Receipts.

A limited organizational chart listing the insurance companies in the Holding Company System of which the Company was a member as of December 31, 2005 is as follows:



**MANAGEMENT AND CONTROL**

Control

HLICD is a wholly owned subsidiary of HIG. The ultimate parent of the entire corporate organization is HSBC. As of December 31, 2005, HSBC reported the following:

Assets	\$ 1,489,000,000,000
Stockholder's equity	92,000,000,000
Net Income	62,000,000,000

Management

Pursuant to the General Corporation Laws of the State of Delaware, as implemented by the Company's Certificate of Incorporation and bylaws, adopted October 25, 2000, all business and affairs of the Company shall be managed by the Board of Directors consisting of "not less than three (3) and not more than fifteen (15)" directors. The directors shall be elected by the stockholder at the annual meeting of the stockholder. Each director shall serve until the next annual meeting of the stockholder and until its successor shall be elected and qualified. The Company amended Article III, Section 6 of the bylaws September 23, 2005 to eliminate quarterly meetings and to have regular meetings of the Board without notice at the registered office of the Corporation.

As of December 31, 2005 there were no outside directors and the following individuals served as directors:

Director  
Charles Emory Compton III  
Patrick Anthony Cozza  
J. Kevin McCarthy  
Timothy Joseph Titus\*

\*resigned in 2006

Committees of the Board of Directors

The Board of Directors had the following committee in place as of December 31, 2005:

Executive Committee  
Patrick A. Cozza  
Timothy J. Titus  
J. Kevin McCarthy

Officers

Article V of the bylaws provide that the officers of the Company shall consist of a President, Secretary, Treasurer and such other officers appointed by the Board of Directors. As of December 31, 2005, the Company's principal officers and their respective titles were as follows:

<u>Name</u>	<u>Title</u>
Mary Ann Carroll	Assistant Secretary
Charles Emory Compton III	Vice President/Chief Finance Officer/Treasurer
Patrick Anthony Cozza	President/Chief Executive Officer
Anthony Joseph Del Piano	Secretary
William Heynacher Kesler	Vice President/Senior Investment Officer
Gerard Lunemann	Vice President/Chief Actuary
J. Kevin McCarthy	Senior Vice President/Business Development
Jeffrey Joseph Medeiros	Assistant Secretary
Dennis Joseph Mickey	Vice President/Treasury
Perry Joseph Morelli	Vice President/Treasury
Cheryl Kingsfield Neal	Vice President Marketing
Stephen James Tich	Vice President/Chief Operations
Timothy Joseph Titus	Vice President/Chief Compliance Officer

**CORPORATE RECORDS**

Corporate Minutes and Meetings

The Board of Directors assesses and approves pertinent transactions as reflected in the corporate minutes and in addition, the Company's business affairs are discussed at its Stockholder and Committee meetings. As prescribed in the bylaws, actions of the Board were conducted by unanimous written consent. The minutes of the meetings of the Stockholder, Board of Directors, and its Executive Committee, which were held during the examination period, were read and noted. Attendance at meetings, election of Directors and Officers, approval of investment transactions, and capital and dividend transactions were also noted.

Conflict of Interest Policy

The Company adopted a Code of Ethics for standards of business conduct that includes its policy for conflicts of interest. Conflict of Interest Compliance Questionnaires were distributed and signed by all the principle officers of the Company as well as to members of the Board of Directors.

### **MANAGEMENT AND SERVICE AGREEMENT**

The Company was a party to the following agreements as of the examination date. A brief summary of the agreements follows:

#### **Tax Allocation Policy – Household Life Insurance Company of Delaware Life – Life Group**

The Company participates in a consolidated federal income tax allocation agreement effective for taxable years commencing on or after January 1, 2001, along with its life insurance subsidiaries HLIC-AZ and HLIC. HLICD and its affiliates constitute an affiliated group within section 1504(a) of the Internal Revenue Code of 1986 of which HLICD is the common parent and, therefore, eligible to file a consolidated United States federal income tax return and pay federal income taxes on a consolidated basis if necessary. Federal income tax expense and benefits are allocated in the ratio that the Company's separate tax return liability or benefit bears to the sum of the separate return tax liabilities and benefits of the Household Life Insurance Company of Delaware Life – Life Group. Estimated payments are made between members during the year.

#### **Management Services Agreement - Household Finance Corporation (n/k/a HSBC Finance Corp)**

The Company has no employees and pursuant to a management service agreement with Household Finance Corporation (HFC), a subsidiary of its ultimate parent. HLICD utilizes the services of HFC, its officers and employees, to conduct all operations of the company. Under this agreement, management service expenses, salaries and benefits, and facility occupancy charges are

Household Life Insurance Company of Delaware

allocated to the Company. Total amounts paid under the agreement for 2005, 2004 and 2003, were \$478,710, \$46,149 and \$9,292 respectively.

Investment Advisory Agreement - HI (n/k/a HSBC Finance Corp)

An Investment and Cash Management Services Agreement originally entered into on January 1, 1997 between HLIC and HI was amended, effective January 1, 2001, to include HLICD.

Per the Agreement, HI will provide various investment management services including, but not limited to, purchasing and selling investment securities in HLICD's portfolio; administration of HLICD's portfolio; management and oversight of external asset managers; reconciliation of investment custody statement(s); and maintenance of investment ratings and security valuations. The fee for such services will be cost "based upon actual time and effort." It is noted that all cash and investment management services provided by HI are subject to verification by the Company. In addition, the Agreement notes that separate custody accounts will be maintained and that there is to be no commingling of funds.

Administrative Service Agreement – BFC Insurance Agency of Nevada (BFC)

The Company on October 1, 2003 entered into an administrative service agreement with BFC whereby BFC performs certain administrative services and operational transactions i.e., collect and remit premiums, on various insurance programs the Company issues to its customers. An arm's length charge for the services rendered is imposed and settled up via the inter-company billing process.

During the review of the management and service agreements, it was noted the participants in the agreements did not reflect the current organizational changes and correct name changes approved in both 2004 and 2005 by the Delaware Department of Insurance.

**It is recommended that the Company review its management and services agreements and file the appropriate agreements with the Delaware Insurance to reflect the correct participating entities.**

### **TERRITORY AND PLAN OF OPERATION**

The Company is licensed to transact the business of life insurance, including annuities and credit life, in the state of Delaware primarily, through their relationships with HSBC Banks and HFC. The Company does not have an agency system but has service agreements with HFC and BFC to produce business, both affiliates of the Company. The Company as of December 31, 2005 reported 63 individual agent appointments for the Company. The company currently has no plans to obtain licenses outside of Delaware.

The Company's principal line of business is credit life insurance. Premiums for this product, which were generated through its affiliations with other HSBC Finance Corporation subsidiaries, for the years ended December 31, 2005, 2004 and 2003 were \$487,103, \$318,152 and \$164,478 respectively. All the premiums for the period under examination were direct single premiums.

As of December 31, 2005 the Company was not a party to any reinsurance agreements, either affiliated or unaffiliated.

### **GROWTH OF THE COMPANY**

The following information was obtained from the Company's filed Annual Statements:

<u>Year</u>	<u>Admitted Assets</u>	<u>Surplus</u>	<u>Premiums, Annuity Considerations and Deposits</u>	<u>Net Income</u>
2005	\$812,690,292	\$807,794,112	\$487,103	\$85,706,957
2004	697,913,013	677,460,568	318,152	80,173,670
2003	627,057,120	600,243,286	164,478	79,513,752
2002	513,300,329	510,196,414	599,539	78,460,368

The Company has experienced significant growth during the period under examination.

This growth has taken the form of the following:

- A 58.3% increase in admitted assets
- A 58.3% increase in surplus
- A 18.8% decrease in premium, annuity considerations and deposits
- A 9.2% increase in net income

The following factors contributed to the Company's growth:

The admitted asset increase for the examination period was primarily due to the increased carrying value of \$138 million in the two insurance subsidiaries and the \$95 million increase in bonds.

The decrease in premium revenue for the examination period is the result of the Company discounting the writing single premium credit real estate insurance in April of 2002, which negatively impacted the premium revenue.

### **ACCOUNTS AND RECORDS**

Pursuant to the Management Service Agreement between HLICD and HI, financial accounting records are processed and maintained in conjunction with HI's., computer systems. The Company performs full system backups and rotates copies of programs and data files to its off-site storage facility in accordance with a schedule designed to sufficiently protect the records of the company. The Company has a disaster recovery plan that covers its mainframe operations. The plan is periodically tested.

The statutory-basis financial statements of the Company are audited annually by KPMG LLP, an independent certified accounting firm. The Company's accounts and records are also



subject to review by the internal audit department of HI. Based on the examination review of Annual Statement classifications and discussions with management, the accounting system and procedures generally conformed to insurance accounting standard practices and requirements.

## **FINANCIAL STATEMENTS**

The following statements show the assets, liabilities, surplus and other funds of the Company, as determined by this examination, as of December 31, 2005.

Analysis of Assets  
Liabilities, Surplus and Other Funds  
Summary of Operations  
Capital and Surplus Account  
Examination Financial Changes

### **Analysis of Assets** **December 31, 2005**

	<u>Ledger</u> <u>Assets</u>	<u>Non-admitted</u> <u>Assets</u>	<u>Net Admitted</u> <u>Assets</u>	<u>Notes</u>
Bonds	\$191,765,312	0	\$191,765,312	1
Common stocks	515,602,246	0	515,602, 246	2
Cash and short-term investments	103,158,959	0	103,158,959	
Receivables for securities	2,493	0	2,493	
Investment income due & accrued	2,121,607	0	2,121,607	
Receivables from parent, subsidiary, & affiliates	39,675	0	39,675	
	<hr/>			
Totals	\$812,690,292	0	\$812,690,292	
	<hr/>			

**Liabilities, Surplus and Other Funds**  
**December 31, 2005**

			<u>Note</u>
Aggregate reserve for life contracts	\$	379,622	3
Contract claims: Life		40,926	
Interest maintenance reserve		675,227	
Taxes, licenses and fees due and accrued		2,376	
Current federal and foreign income taxes		1,992,445	
Net deferred tax liability		122,982	
Miscellaneous liabilities:			
Asset valuation reserve		546,021	
Payable to parent, subsidiaries and affiliates		<u>136,581</u>	
Total Liabilities	\$	<u>3,896,180</u>	
Common capital stock		1,000,000	
Gross paid in and contributed surplus		327,613,074	
Unassigned funds		<u>480,181,038</u>	
Surplus	\$	<u>808,794,112</u>	
Total Liabilities, Surplus and Other Funds	\$	<u>812,690,292</u>	

**Summary of Operations**  
**December, 31, 2005**

Premiums and annuity considerations	\$ 487,103
Net investment income	87,693,840
Amortization of interest maintenance reserve	<u>181,784</u>
Total	\$ <u>88,362,727</u>
Death benefits	109,645
Increase in aggregate reserves for life contracts	<u>(262,829)</u>
Totals	\$ (153,184)
General insurance expenses	488,478
Insurance taxes, licenses and fees, excluding federal income taxes	<u>10,961</u>
Totals	\$ <u>346,255</u>
Net gain from operations before dividends to policyholders and federal income taxes	\$ <u>88,016,472</u>
Net gain from operations after dividends to policyholders and before federal taxes	\$ 88,016,472
Federal income taxes incurred	<u>2,309,515</u>
Net gain from operations after dividends to policyholders and federal taxes and before realized capital gains or (losses)	\$ <u>85,706,957</u>
Net income	\$ <u>85,706,957</u>

**Capital and Surplus Account**  
**December 31, 2004 to December 31, 2005**

Capital and surplus, December 31, 2004	\$ <u>678,460,568</u>
Net income	\$ 85,706,957
Change in net unrealized capital gains or (losses)	2,424,135
Change in net deferred income tax	(69,432)
Change in non-admitted assets and related items	42,433,276
Change in asset valuation reserve	<u>(161,392)</u>
Net change in capital and surplus for the year	\$ <u>130,333,544</u>
Capital and surplus, December 31, 2005	\$ <u>808,794,112</u>

**Examination Financial Changes**

No financial changes were made for examination report purposes.

**NOTES TO FINANCIAL STATEMENTS**

Note 1

<u>Bonds</u>	<u>\$191,765,312</u>
--------------	----------------------

Bonds comprised 24% of assets at year-end 2005. Bonds were primarily corporate holdings, U.S. Government agencies and collateralized mortgage obligations. All of the securities had NAIC designations of 1 or 2. There were no investments or concentrations that violated the Delaware Insurance Code.

Note 2

<u>Common Stock</u>	<u>\$515,602,246</u>
---------------------	----------------------

Common stocks comprised 64% of the company's assets at year-end 2005. Common stocks are entirely comprised of the Company's two wholly owned subsidiaries, which were contributed to HLICD by HIG on January 1, 2001:

Household Life Insurance Company of Delaware

Household Life Insurance Company of Arizona	\$ 24,692,184
Household Life Insurance Company (Michigan)	<u>490,910,062</u>
Total	<u>\$ 515,602,246</u>

Household Life Insurance Company of Arizona

The company is a life and health insurance company, which manages a portfolio of periodic payment annuities on a run-off basis and is not currently writing or marketing any new business currently in run off and had no premium income in the year ended December 31, 2005. The company is licensed only in the state of Arizona. The company posted the following statutory financial results for the year ended December 31, 2005:

Total Assets	\$ 953,823,322
Total Liabilities	929,131,138
Capital and Surplus	24,692,184
Net Income	(33,620,703)
Premium Income	-0-

Household Life Insurance Company (Michigan) (HLIC)

The Company is a life and accident and health insurance company, which primarily writes group and individual credit insurance, including both life and health insurance and is licensed in 46 states plus the District of Columbia and Canada. The Company posted the following statutory financial results for the year ended December 31, 2005:

Total Assets	\$1,050,447,346
Total Liabilities	559,537,284
Capital and Surplus	490,910,062
Net Income	103,381,221
Premium Income	223,873,933

Note 3

Aggregate Reserve for Life Policies and Contracts

\$379,622

This liability consists entirely of credit life single premium decreasing term insurance. The maximum benefit period is five years and contracts may be issued on either a single or joint life basis. During the examination, a judgmental sample of credit life certificates was selected for reserve factor-testing purposes. Data validity (including actual death benefit patterns) was performed by the examiners. No errors were noted. Inclusion testing was also performed to ensure that valuation files were complete. The Department's consulting actuary, INS Consultants, Inc. (INS), verified the reserve for each policy in the sample. INS reserves were slightly higher than those calculated by the Company. This resulted from INS using a linearly decreasing death benefit pattern. Actual Company death benefits were consistently less than the INS amounts and accounted for the differences in reserves. INS verified that the methodology was reasonable. INS concluded that the aggregate reserve for life contracts as reported by the Company in the December 31, 2005 Annual Statement appears fairly stated.

**COMPLIANCE WITH PRIOR REPORT OF EXAMINATION**

The prior examination report contained no recommendations.

**RECOMMENDATIONS**

1. It is recommended that the Company review its management and services agreements and file the appropriate agreements with the Delaware Insurance to reflect the correct participating entities. (Page 11)

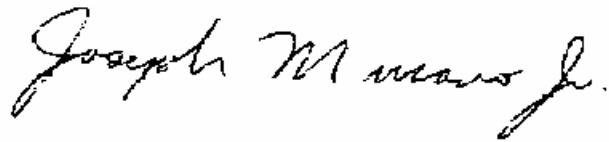
**CONCLUSION**

The following schedule shows the results of this examination and the results of the prior examination with changes between the examination periods:

<b><u>Description</u></b>	<b><u>December 31, 2002</u></b>	<b><u>December 31, 2005</u></b>	<b><u>Increase</u></b>
Assets	\$513,300,329	\$812,690,292	\$299,389,963
Liabilities	2,103,915	3,896,180	1,792,265
Capital and Surplus	511,196,414	808,794,112	297,597,698

The assistance of Delaware's consulting actuarial firm, INS Consultants, Inc. is acknowledged.

Respectfully submitted,



---

Joseph Murano Jr., CFE  
Examiner In-Charge  
State of Delaware